

15
FILED
APR 28 1942

CHARLES ELMORE CHAPLEY
CLERK

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 1186

MODERN FACTORS COMPANY,

Petitioner,

vs.

TASTYEAST, INC.

PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE THIRD CIRCUIT AND BRIEF IN SUP-
PORT THEREOF.

MAX L. ROSENSTEIN,
Counsel for Petitioner.

INDEX.

SUBJECT INDEX.

	Page
Petition for writ of certiorari.....	1
Summary statement of matter involved.....	1
Reasons relied upon for the allowance of the writ..	5
Prayer for writ.....	9
Appendix A. Constitutional provisions, Federal statute and general law involved.....	10
Appendix B. Questions presented.....	11
Appendix C. Recommendation on rate of interest to be paid to Modern Factors Company.....	12
Brief in support of petition.....	15
Opinion below.....	15
Jurisdiction.....	15
Statement of case.....	16
Constitutional provisions, federal statutes and general law involved.....	16
Specification of errors.....	16
Argument.....	17
Point 1—The decision of the Circuit Court of Appeals in the instant case is in direct conflict with, and contrary to, the decisions of this Court and other Circuit Courts of Appeal, and deprives petitioner of its property and rights to property without due process of law.....	17
Point 2—The Circuit Court of Appeals in denying petitioner agreed interest on its secured claim to the date of payment, ruled contrary to the established principles of law laid down by this Court that a creditor holding a secured claim is entitled to interest to the date of payment.....	20
Point 3—Under the applicable decisions of the courts of New Jersey, the agreement for the rate of the interest provided for in the mortgage was not an agreement for a penalty. In failing to follow these decisions the Circuit Court of Appeals below erred..	23

Point 4—The Circuit Court below in rendering its decision has decided an important question of general law in a way untenable and in conflict with the great weight of authority.....	26
Conclusion.....	27

TABLE OF CASES CITED.

<i>American Iron & Steel Co. v. Seaboard Airline Ry.</i> , 233 U. S. 261, 43 Sup. Ct. 502, 59 L. Ed. 949.....	6, 20
<i>Board of Commissioners v. Bernardin</i> , 74 Fed. 809.....	6
<i>Case v. Los Angeles Lumber Products Co.</i> , 308 U. S. 106, 84 L. Ed. 110, 60 Sup. Ct. 1.....	6, 17
<i>Central Trust Co. v. Condon</i> , 67 Fed. 84.....	6
<i>Chapman v. Security etc. Bank</i> , 111 F. (2d) 86.....	6, 19
<i>Coder v. Arts</i> , 152 Fed. 943.....	6
<i>Continental Illinois National Bank & Trust Co. v. Chicago, Rock Island and P. Ry. Co.</i> , 294 U. S. 648, 79 L. Ed. 1110.....	5, 17
<i>Cumberland Mfg. Co. v. DeWitt</i> , 237 U. S. 447, 35 Sup. Ct. 636, 59 L. Ed. 1043.....	6
<i>Dayton v. Stanard</i> , 60 L. Ed. 1190, 241 U. S. 598.....	13
<i>Deep Rock Oil Corp.</i> , In re, 113 F. (2d) 266.....	6, 20
<i>Downey v. Beach</i> , 78 Ill. 53.....	25
<i>Fidelity Union Trust Co. v. Field</i> , 311 U. S. 169, 85 L. Ed. 109.....	25
<i>Finkel v. Lepkin</i> , 62 N. J. L. 580.....	9, 26
<i>Fox v. Cronan</i> , 47 N. J. L. 493.....	9, 26
<i>Garden City Canning Co.</i> , In re, 29 Fed. Supp. 13.....	7
<i>Gotham Can Company case</i> , 48 F. (2d) 540.....	6, 22
<i>Herweg</i> , In re, 119 F. (2d) 941.....	6, 19
<i>International Raw Material Corp.</i> , 22 F. (2d) 920.....	6, 21
<i>Kothe v. Taylor</i> , 280 U. S. 224.....	8, 25
<i>Lloyd v. Scott</i> , 4 Pet. 205, 7 L. Ed. 833.....	7, 24
<i>Louisville Joint Stock Land Bank v. Radford</i> , 295 U. S. 555, 55 Sup. Ct. 854, 79 L. Ed. 1593.....	5, 17
<i>Martin Custom Made Tire Corp.</i> , In re, 108 F. (2d) 172.....	13
<i>McFarlan v. Hurley</i> , 286 Fed. 355.....	6
<i>333 North Michigan Ave. Bldg. Corp.</i> , In re, 84 F. (2d) 936.....	6, 18

	Page
<i>Ramsey v. Morrison</i> , 39 N. J. L. 591	7, 23
<i>Security First National Bank v. Rindge Land and Navigation Co.</i> , 85 F. (2d) 557	7, 17
<i>Sexton v. Dreyfus</i> , 219 U. S. 339, 31 Sup. Ct. 256, 55 L. Ed. 244	23
<i>Smith v. Koenig</i> , 57 N. J. L. 486	9, 26
<i>Spring Coal Co. v. Keech</i> , 249 Fed. 38	6

STATUTES CITED.

Bankruptcy Act, Article X, Sec. 216, sub-division (7) ..	10
Bankruptcy Act, Article XI, Sec. 221, sub-division (2) ..	11
Constitution of the United States, Fifth Amendment ..	9, 10
Constitution of the United States, Fourteenth Amendment, Section 1	9, 10
Judicial Code, Sec. 240(a), 28 U. S. C. A. sec. 347(a) ..	15

TEXT CITED.

82 A. L. R. 1214	26
------------------------	----

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1941

No. 1186

MODERN FACTORS COMPANY,

Petitioner,

vs.

TASTYEAST, INC.

**PETITION FOR WRIT OF CERTIORARI TO THE
UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE THIRD CIRCUIT.**

*To the Honorable Chief Justice and Associate Justices of
the Supreme Court of the United States:*

Summary Statement of Matter Involved.

1. This case challenges the correctness of a decision by the United States Circuit Court of Appeals for the Third Circuit which reversed that portion of a decree of the United States District Court for the District of New Jersey confirming a plan of reorganization proposed on the part of Tastyeast, Inc. The said decree directed the payment of \$5,645.87 as interest in addition to the amount of a mortgage held by Modern Factors Company covering the chat-

tels of Tastyeast, Inc. The United States Circuit Court of Appeals for the Third Circuit ruled that the agreement to pay the aforesaid interest constituted a penalty and, therefore, unenforcible in bankruptcy.

2. On June 25, 1940, Tastyeast, Inc., a Delaware corporation filed a petition for reorganization under Chapter X of the Bankruptcy Act in the United States District Court for the District of New Jersey. The petition was approved, and the duly appointed trustee took possession of the debtor's business. Subsequently, in the reorganization proceedings, the debtor was adjudged insolvent, but was never adjudicated a bankrupt.

3. On March 25, 1940, the debtor gave its note, as evidence of a debt owing by it to Modern Factors Company, in the sum of \$33,600.00; and, to secure the payment thereof, with interest, executed a chattel mortgage which, by its terms, matured on September 25, 1940. (Appendix below, pp. 8-9.) At the time of the filing of the petition for reorganization, the principal indebtedness had been reduced by payments to the sum of \$31,600.00. At maturity the balance of the principal became due and was not paid. The debtor was in default. From and after September 25, 1940, interest on said unpaid balance was to be paid at the rate of $2\frac{1}{2}\%$ per month. (Appendix below, p. 9.)

4. The debtor proposed a plan of reorganization, subsequently altered, which made provision for the payment of the mortgage debt, and, among other things, provided for the formation of a new company, “* * * to which shall be transferred all of the property and assets of the debtor, and which shall stand in the same position with respect to the altered plan as debtor”. (10 (a) Order Confirming Altered Plan, etc., Appendix, p. 3.)

5. Under the plan, as altered, it was also proposed that the mortgagee was to be paid interest on the principal

balance of its debt after September 25, 1940, *not at the rate fixed by the contract, but at a rate to be fixed by the court upon hearing for confirmation of the plan.*

6. Modern Factors Company was the only creditor of its class. The foregoing proposal in the altered plan was intended to specifically apply to, and affect the claim of, Modern Factors Company as a secured creditor, and the only one of its class. Objection was made on the part of this creditor to the approval of the plan, contending that the debt due to it was fixed by the contract which could not be impaired by the court without its consent; and, that the court could not legally adjudicate the proposed altered plan to be fair, equitable, and feasible unless provision was made therein for the payment of the mortgagee's claim in full, with interest, as provided for in the chattel mortgage.

7. On due notice, application was made by the debtor, to the Referee in Bankruptcy before whom the reorganization proceedings were pending, to have the interest which had accrued since maturity of the mortgage, fixed.

8. The Referee reported to the District Court (a) that there was no question about the validity of the mortgage in the case at bar; (b) that the Court was considering a reorganization proceeding, and there appeared to be a serious doubt that security could be taken away from a secured creditor without paying him in full, unless the claim was an illegal one; and, (c) that the contract here was free from fraud and duress. The Referee upheld the contentions of Modern Factors Company. (See Referee's Report on Confirmation of Altered Plan, which was part of the record on appeal in the court below, and appears in Appendix "C" hereto annexed, and referred to on page 3, Appendix below.) The Referee's findings were approved by the District Judge (Appendix below p. 7). An order was made

by the District Court confirming the altered plan, with leave to the debtor to appeal from that portion of the order which directed the payment of interest to Modern Factors Company at the rate provided for in the mortgage. The amount of said interest was calculated at \$5,645.87, and was deposited with the Clerk of the United States District Court, pending the determination of an appeal, if any were taken. The appeal was taken by the new corporation which succeeded the debtor, and, the United States Circuit Court of Appeals for the Third Circuit reversed the District Court upon the sole ground that the provision in the mortgage which called for the payment of interest at the rate of $2\frac{1}{2}\%$ per month from and after the default which occurred on September 25, 1940, the date of maturity of the mortgage, though not usurious, constituted an agreement for a penalty and was unenforceable in bankruptcy.

9. The Circuit Court of Appeals below refrained entirely from passing upon the contentions urged and sustained on the part of Modern Factors Company in the District Court; namely, (a) that the court could not lawfully take away from the only secured creditor of its class a portion of its claim and give it to the debtor; (b) that a plan of reorganization which contemplated such a result could not be held to be fair, equitable and feasible; and, (c) that a secured creditor was entitled to payment of the full amount of the mortgage debt and agreed interest to the date of payment. The court confined its discussion to, and based its opinion solely upon, the question of penalty. The determination by the Circuit Court below, was based solely upon speculation, and upon an assumption of facts nowhere appearing in the record. (See Conclusions on pages 2 and 6, Opinion C. C. A., Filed March 19, 1942.) (R. 17, 21.) Petitioner contends that the determination by the Circuit Court of Ap-

peals below was erroneous and violative of its constitutional rights, upon the grounds more particularly herein-after set forth.

10. This is a petition for a Writ of Certiorari to review the decision of the United States Circuit Court of Appeals for the Third Circuit, and, the questions presented for determination upon this petition are set forth in Appendix "B" hereto annexed.

Reasons Relied Upon for the Allowance of the Writ.

1. This case presents questions of constitutional issues which, petitioner contends, were determined in its favor in the District Court after full consideration of all questions of fact and law.

2. The determination of the United States Court of Appeals for the Third Circuit reversing the District Court deprives petitioner of its property and rights to property without due process of law, and is in complete disregard of the rights of petitioner, which did not consent to the reduction of its claim or the modification of its rights. Petitioner contended that the plan of reorganization could not be adjudicated fair, equitable, and feasible unless petitioner's claim was paid in full, together with agreed interest to the date of payment.

3. It is respectfully submitted that the determination by the Circuit Court of Appeals below is clearly erroneous and not in accord with the principles of applicable decisions of this court in the following cases, among others:

Louisville Joint Stock Land Bank v. Radford, 295 U. S. 555, 55 S. Ct. 854, 79 L. Ed. 1593;

Continental Illinois National Bank & Trust Co. v. Chicago Rock Island and P. Ry. Co., 294 U. S. 648, 79 L. Ed. 1110;

Cumberland Manufacturing Co. v. Dewitt, 237 U. S. 447, 35 S. Ct. 636, 59 L. Ed. 1043;
333 North Michigan Ave. Bldg. Corp., 84 F. (2d) 936;
Case v. Los Angeles Lumber Products Co., 308 U. S. 106, 84 L. Ed. 110;
In re Herweg, 119 F. (2d) 941;
In re Chapman v. Security &c. Bank, 111 F. (2d) 86.

4. Insofar as the decision denied to petitioner the right to payment of the full amount of its mortgage debt, with interest to the date of payment at the rate fixed by written agreement between the parties, the same is not in accord with the decisions of this court. *In re American Iron & Steel Co. v. Seaboard Airline Ry.*, 233 U. S. 261, 43 S. Ct. 502, 59 L. Ed. 949; *Louisville Joint Stock Land Bank v. Radford*, *supra*; *Continental Illinois National Bank & Trust Co. v. Chicago*, *supra*; *Case v. Los Angeles Lumber Products Co.*, *supra*; and, the said decision conflicts and is irreconcilable with the decisions of the Circuit Courts of Appeal in the Second, Fourth, Fifth, Sixth, Eighth, and Tenth Circuits, in the following cases:

In re Deep Rock Oil Corp., 113 F. (2d) 266 (C. C. A. 10th Cir.);
Spring Coal Co. v. Keech (C. C. A. 4th Cir.) 249 Fed. 38;
Central Trust Co. v. Condon (C. C. A. 6th Cir.), 67 Fed. 84;
McFarlan v. Hurley (C. C. A. 5th Cir.), 286 Fed. 355;
Board of Commissioners v. Bernardin (C. C. A. 10th Cir.), 74 Fed. 809;
First National Bank v. Ewing (C. C. A. 2nd Cir.);
Gotham Can Company Case, 48 F. (2d) p. 542 (C. C. A. 2nd Cir.);
In re Matter of International Raw Material Corp., 22 F. (2d) (C. C. A. 2nd Cir.);
In re Coder v. Arts (C. C. A. 8th Cir.) 152 Fed. 943.

5. The United States Circuit Court of Appeals for the Third Circuit clearly erred, we submit, by unlawfully extending the scope and operation of Chapter X of the Bankruptcy Act; and, by its decision conferred a license upon the debtor seeking reorganization to retain to its own use property pledged by it as security for its debt, and to impair that debt. This determination is contrary to the accepted principles applicable to the facts in the case at bar, and is utterly in conflict with the decisions of this court and other Circuit Courts of Appeal. The Circuit Court of Appeals below disregarded the distinction between the administration of the estate of a bankrupt as distinguished from the manner in which assets of a corporate debtor are dealt with in reorganization proceedings. The cases disregarded and overruled are:

In re Garden City Canning Co., 29 Fed. Supp. 13;
In re Security First National Bank v. Rindge Land and Navigation Co., 85 F. (2d) 557 (C. C. A. 9th Cir.);
Case v. Los Angeles Lumber Products Co., *supra*.

6. To the extent that the decision below sustained the claim that the agreement for the payment of the interest provided for in the mortgage after maturity was a penalty and, therefore, unenforceable, it is not in accord with the applicable decisions of the State of New Jersey on the question of whether a contract such as existed in the case at bar, constituted an agreement for an unenforceable penalty. The New Jersey Supreme Court in *re Ramsey v. Morrison*, 39 N. J. L. 591, 593, held that a contract to increase interest after default is not an agreement to exact a penalty. The same rule was laid down by this court in *re Lloyd v. Scott*, 4 Pet. 205, 7 L. Ed. 833; and, is the rule which prevails in the States of Arkansas, Idaho, Iowa, Illinois, Maine, Massachusetts, Minnesota, Nebraska, New Jersey, Oregon, Virginia, Wisconsin, and in England.

7. The United States Circuit Court of Appeals for the Third Circuit went beyond and de hors the record for the basis of its determination. The decision of the court below rests upon assumptions of fact nowhere appearing in the record, and was predicated upon speculation. (See pages 2 and 6 of Opinion, C. C. A., March 19, 1942.) (R. 17, 21.)

8. The case relied upon by the Circuit Court of Appeals below, to wit, *Kothe v. Taylor*, 280 U. S. 224-226, is clearly distinguishable and inapplicable, for, the theory underlying the decision in that case was that the parties to the contract therein were consciously undertaking to contract for payment to be made out of the assets of a bankrupt estate at the expense of the creditors, and not for something which the lessee there personally would be required to discharge.

9. In the case at bar, the creditors are not affected by the contract, but the debtor alone, and, it is the debtor who seeks to obtain the benefit of its own contract, resorting to reorganization under Chapter X to accomplish what it could not otherwise achieve.

10. The Circuit Court below in rendering its decision has decided an important question of general law in a way untenable and in conflict with the great weight of authority which holds that a provision in a note or other contract for the payment of money by which the debtor agrees to pay, after maturity and default, interest at a higher rate than permitted by the usury laws, or, a sum of money which will exceed that rate, does not render a note or other contract usurious if the parties in making the contract act in good faith, without intent to evade the usury law. In the case at bar, the good faith of the chattel mortgagee has never been questioned, and the mortgage

was found to be free from fraud and duress. (See Referee's Opinion, Appendix "C" hereto annexed).

11. The decision by the court below stripped the mortgagee of its contract rights, and unlawfully conferred the benefits thereof upon the debtor. This constituted a taking away of a substantive property right of the mortgagee, contrary to the Fifth and Fourteenth Amendments of the Constitution of the United States, and was contrary to the rights of the mortgagee under the case of *Fox v. Cronan*, 47 N. J. L. 493, cited with approval in *Smith v. Koenig*, 57 N. J. L. 486, and *Finkel v. Lepkin*, 62 N. J. L. 580.

12. In the interest of brevity (Rule 38, paragraph 2) petitioner restricts further discussion on these points, but in order to comply with the rules of this court which require that all issues upon which decision is requested be presented in the petition for certiorari, petitioner here refers to and incorporates into this petition, all of the matters presented to the United States Circuit Court of Appeals for the Third Circuit in the transcript of the record on appeal, with the same force and effect as if herein set out in full.

WHEREFORE, petitioner prays that a Writ of Certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Third Circuit, commanding that court to certify and send to this court for its review and determination, on a day certain to be therein named, a transcript of the record and proceedings herein; and, that the decree of the United States Circuit Court of Appeals for the Third Circuit be reversed by this Honorable court, and, your petitioner have such other and further relief in the premises as to this Honorable court may seem meet and just.

MAX L. ROSENSTEIN,
Counsel.